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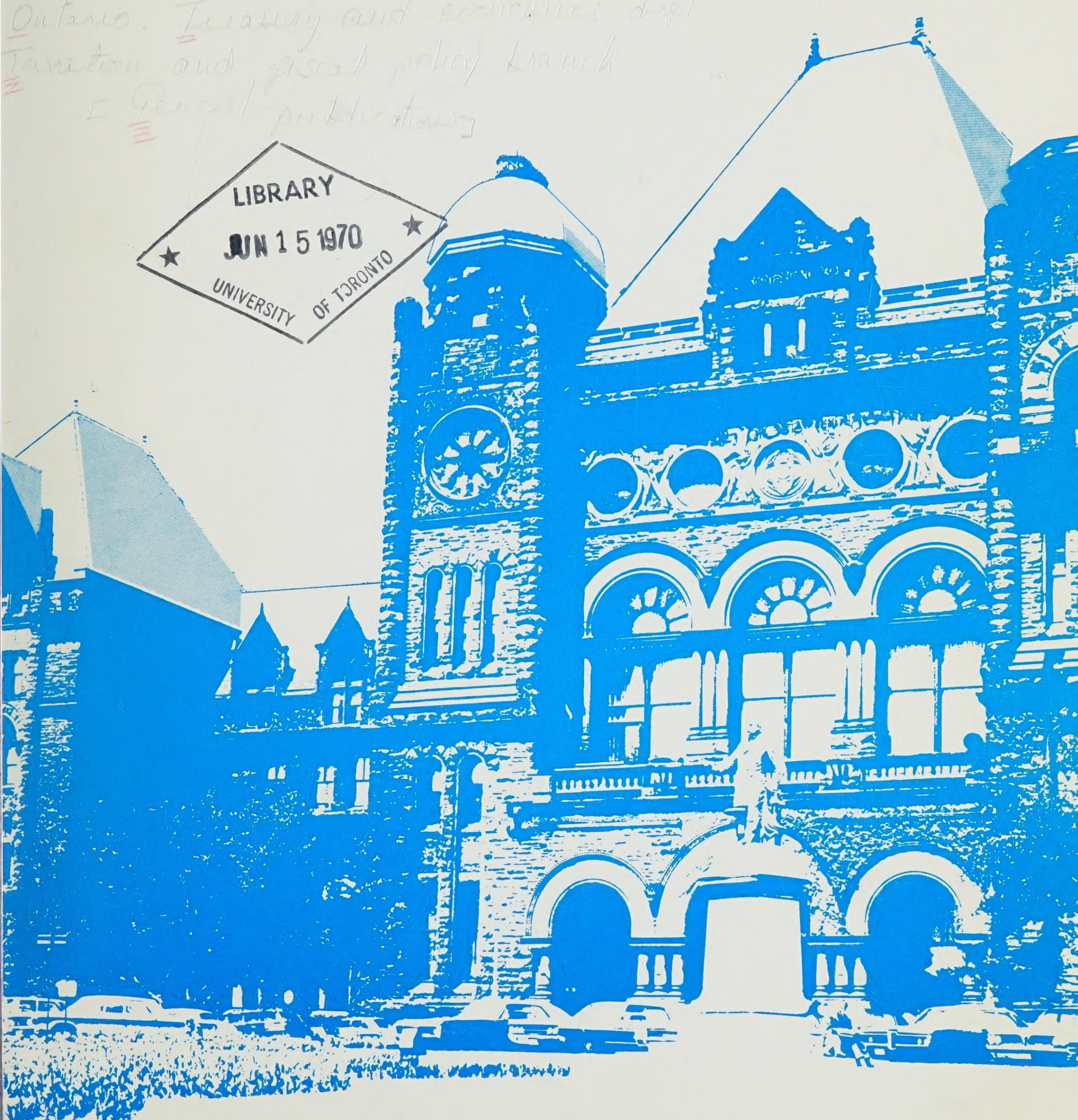
The Honourable Charles MacNaughton
Treasurer and Minister of Economics



ONTARIO PROPOSALS

FOR TAX REFORM IN CANADA

ONTARIO

The Honourable Charles MacNaughton
Treasurer and Minister of Economics

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PREFACE

Canadian federalism places the responsibility for the welfare of Canadians on two levels of government – federal and provincial – and provides that each level has an equal right to raise needed revenues through income taxation. The income tax is one of the most pervasive influences in our society and the form and level of income taxation is a significant instrument in determining the nature of our society and economy.

This is why the Ontario Government has not limited its interest in tax reform to provincial or municipal taxation alone. Rather, as the spokesman for the largest province in Canada, the Government is convinced that an approach to taxation which benefits Canada and Canadians most is also best for Ontario and its citizens.

A properly conceived national income tax system, worked out through practical co-operation by the federal government and provincial governments, is the only way that the necessary redistribution of total tax burdens on individual Canadians can take place. It is also the only way of ensuring the most rapid, efficient and balanced growth of the Canadian economy on which so much of our success as a nation depends.

A national debate on taxation has been going on for some time. The Ontario Government has contributed to this debate on a number of previous occasions. Now, in presenting its proposals for comprehensive national tax reform, the Government hopes that they will be considered, along with the federal white paper, by all Canadians, by the federal and other provincial governments, and by the two Parliamentary Committees studying tax reform.

Tax reform is a continuous process. Our proposals for tax reform in Canada do not represent the Ontario Government's last word on every aspect of national taxation. It does, however, set out clearly the twin thrust of our tax reform approach – redistribution of tax burdens for individual Canadians and provision of incentives for Canadians to contribute to national objectives, both within the context of a maturing economy.

"One Canada" does not mean the federal government alone. It means the federal and provincial governments in partnership. Whether we have, in effect, one or several Canadas in the seventies will be determined in large measure by the nature of national tax reform.

The Honourable Charles MacNaughton
Treasurer of Ontario and Minister of Economics

June, 1970

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1 INTRODUCTION

The Ontario Government has strong and positive views on the reform of income taxation in Canada.

We start from the position that the income tax fields belong to the provinces as well as to the federal government. Consequently, no changes should be implemented without the full agreement of both taxing jurisdictions. The Ontario Government insists that income tax reform must be a co-operative venture, not simply a unilateral exercise by the federal government. We look upon the income tax as the pivotal point of a new and more equitable tax structure. In our own white paper, we proposed an independent and redesigned income tax for Ontario, to connect and co-ordinate the provincial and municipal tax systems and allow control over the level and distribution of overall tax burdens.[1] As yet, we have not proceeded with this proposal because we firmly believe in first exploring all avenues towards the same objectives through a national, uniform tax system.

The Government of Ontario strongly favours tax reform. Our taxpayers are expecting genuine reform and they deserve no less. We are putting forward our views, therefore, as a constructive contribution to the achievement of a fairer and better tax system for the people of Ontario and Canada.

The Setting for Reform

Our mutual goal in reform should be the redistribution of total federal-provincial-municipal tax burdens. In Canada, we have had a succession of major studies on tax reform, including the Carter Commission, Ontario's Smith Committee and tax studies by other provinces. However, each of these was incomplete; they did not look at the total tax system, federal-provincial-municipal, bearing upon taxpayers. In recognition of this serious flaw, Ontario advocated comprehensive tax reform in its own white paper. Unfortunately, the subsequent federal white paper again pursued a partial and piecemeal approach, with changes in federal income taxes proposed in isolation from earlier changes in death taxes, and unrelated to provincial and municipal taxes. We are in fundamental disagreement with this approach. We must reassert that comprehensive tax reform is the only way to achieve real reform. Unless the federal-provincial-municipal tax system is redesigned in a comprehensive and co-ordinated manner, meaningful redistribution of tax burdens cannot be achieved and the best interests of taxpayers will not be served.

In the view of the Ontario Government, the second overriding requirement for lasting tax reform is the containment of total tax burdens. The biggest problem of the present tax

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[1] Hon. Charles MacNaughton, "The Reform of Taxation and Government Structure in Ontario", *Ontario Budget 1969*, Department of Treasury and Economics, Taxation and Fiscal Policy Branch.

system is that taxes are too high. Canada's tax structure has been overloaded by steady tax increases during the last two decades in order to finance excessive growth in public spending. In 1952 expenditures by all governments accounted for only 26 per cent of Gross National Product. This claim by governments has steadily increased, with the result that public spending now pre-empts almost 35 per cent of Gross National Product. If this trend continues, the benefits of tax reform, however worthy, will be quickly wiped out by more tax increases. In both its 1969 and 1970 Budgets, the Ontario Government stressed the need for a constructive and fairminded review of federal-provincial expenditure requirements and financial capacities, within a total framework of national priorities and taxation control. We again urge that expenditure reform be pursued hand in hand with tax reform. Only by containing and co-ordinating public spending can there be any assurance to taxpayers that their taxes will not continue to rise inexorably throughout the 1970s and 1980s.

Tax reform should look to the future, not just the present. We must try to design a new tax system which will suit Canadian needs and serve Canadian objectives throughout the 1970s and 1980s. A reformed tax system should contribute positively to the realization of our basic social goals: a higher standard of living, an improved quality of life and greater opportunity for all Canadians. The essential foundation for these ends is a dynamic and efficient economy, producing a growing national income for distribution among our citizens. Thus, the new tax system should encourage savings, initiative and enterprise which generate the growth and create the jobs upon which the ultimate well-being of all our citizens depends. Without such a result, equity will be an illusion, and many taxpayers could be worse off than they would be without tax reform.

Objectives of Tax Reform

The Government of Ontario believes that reform of income taxation should be based on and be evaluated against the following major objectives. It should aim to:

- **Improve equity.** We believe that equity should be viewed in a broad and dynamic sense. Thus, we believe that income tax reform must embrace our poorest citizens even though they pay no income tax. We also believe that a static approach to equity is sterile. Below-potential economic growth or continuing inflation would quickly negate equity gains from reform and leave all our taxpayers worse off, with low-income taxpayers bearing the brunt as usual.
- **Foster economic growth.** We believe that tax reform must preserve sound economic incentives, particularly those which encourage savings, investment and development. The key to optimal tax reform is to harmonize growth and equity to the advantage of each, and redistribute tax burdens without producing economic stagnation and reduced opportunities in the future.

- **Achieve maximum simplicity.** All Canadians are necessarily confronted by taxes. We believe that it is the responsibility of governments to ensure that complexity, confusion and inconvenience to taxpayers are minimized. A reformed income tax system should be comprehensible to ordinary citizens.
- **Encourage Canadian ownership of Canadian business.** The reformed tax system must work to promote the highest possible degree of Canadian ownership and participation in Canadian economic development.
- **Ensure Canadian participation in the world economy.** The new tax system must recognize that economic activity is increasingly becoming organized on an international basis. Canada must look outward, not only for capital and enterprise to assist its own development, but also to participate fully in world economic development through Canadian-based international corporations.
- **Maintain reasonable uniformity in all provinces.** We are concerned about the trend toward balkanization of the national tax structure and the danger of tax competition among governments. National tax reform must recognize this problem. Certainly it should not exacerbate it by imposing unreasonable new taxes, or by imposing an unacceptable tax system which forces provinces to establish independent tax systems.
- **Minimize administration and collection costs.** Complicated and highly technical tax provisions are difficult and expensive to administer. This is particularly true when a major new tax is introduced. The Ontario Government strongly advocates simple and straightforward taxes which can be understood by taxpayers and collected at reasonable cost by governments.
- **Ensure reasonable staging of reforms.** We believe that major tax revisions should be implemented in gradual stages. Our economy and our society can only absorb a limited amount of change at any one time. Far-reaching changes in the tax system tend to create apprehension, confusion and uncertainty. We believe that a gradual approach will reap substantial long-run benefits both for taxpayers and for governments.

We believe these are essential objectives for all Canadians. However, their achievement for all Canadians demands effective partnership of the federal and provincial governments. There is no alternative in our federal system.

2 TAX REFORM AND REVENUES

The main purpose of taxation is to raise revenues in order to finance public services. In reforming the income tax system, therefore, the question of how much revenue should be raised is absolutely critical for a number of reasons.

- A reformed tax system obviously must generate sufficient revenues now and in future to finance existing public programs. The provinces as well as the federal government have a vital interest in changes in income taxation, particularly the personal income tax because of its importance for revenues, stabilization and a balanced tax mix.
- The level of taxation, particularly of income taxes and taxes on capital, has a major bearing on private savings, investment and enterprise. An increase in taxes on income and capital, under a reformed system, could seriously reduce private savings and investment, the key requirements for economic growth and prosperity in Canada in the years ahead.
- Taxpayers are looking forward to real tax reform, not tax increases. It would be a cruel deception to promise the former and deliver the latter.

We take the position, therefore, that a tax reform program should produce no increase in revenue, a position also adopted by the Carter Commission. By contrast, the white paper amounts to an exercise in large-scale tax increases by the federal government, at least $630 million worth according to their own estimates. Our estimates indicate that the revenue gains will be more than twice this large, or over $1.4 billion.[2] We believe that tax increases on such a massive scale are totally unwarranted and undermine the basic purpose of reform. In short, our approach is that tax reforms should meet the needs of taxpayers first and governments second.

The present tax system is already producing a large federal surplus. The last federal budget estimated a surplus of $250 million for 1970-71. If the economy were operating at full employment, the potential surplus would be very much larger. With such surplus fiscal capacity already at hand, why should the federal government seek huge additional revenues as part of its tax reform program? We strongly believe that tax increases should be proposed and legislated on their own merits, and not implemented under the guise of tax reform. Indeed, we think that national tax reform should aim to reduce taxes. By contrast with Canada, the recent United States tax reform legislation entailed a substantial reduction in federal tax revenues and a reduced claim on Gross National Product. We think Canada should be moving in a similar direction. The best guarantee to taxpayers that there will be some control of public spending is to leave resources in the hands of the people.

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[2] *Analysis of the Federal Tax Reform Proposals,* Ontario Department of Treasury and Economics, Taxation and Fiscal Policy Branch, June, 1970.

Revenue Gains Under the Federal White Paper

The federal white paper estimates that there would have been a revenue gain of $630 million if the new system had been fully implemented in 1969. There would have been $560 million of increased revenue from corporations and $70 million of increased taxes on individual taxpayers. Following release of the federal paper on November 7, 1969, we undertook an analysis of the revenue impact. At the meeting of Federal-Provincial Ministers of Finance on February 2, 1970, we presented the preliminary results of our analysis.[3] At that time, we also made a commitment to finalize our work in this area and to publish our entire revenue study. Now that we have completed this exercise, we are making our full study available to all interested parties.[4] Our finished work differs in detail and scope from the preliminary estimates of February 2, but confirms that the overall magnitude of the revenue increase under the federal proposals would be more than twice the federal estimate. The results we are presenting now put this revenue increase at $1.4 billion or more.

Our much higher estimate of the magnitude of tax increases involved in the federal proposals is the result of three factors. First, there are several revenue-reducing proposals, such as child care allowances, which we calculate to be far less generous than suggested in the white paper. In addition, there are revenue-gaining proposals, such as denial of certain expense deductions, which would produce a great deal more revenue than estimated. Second, the proposed changes in corporate taxation would produce more revenues than indicated in the white paper.

The third factor accounting for our higher revenue estimates is the revenue gain from those proposals for which no estimate is made in the white paper. The most important omission is the proposed change in mining taxation, which we estimate would produce an extra $180-$200 million when fully in effect. We recognize that these additional revenues from the extractive industries would not begin to flow until after 1975, because of the transitional provisions that have been promised. Such major tax increases must be considered, however, as an integral part of the total reform package that will affect Canada for the rest of the century. A second major omission is the gain involved in taxing medicare premiums paid by employers. We calculate that this reform will produce $57 million in revenues in Ontario alone and perhaps $75 million nationally. Finally, the white paper proposes to tax non-resident capital gains but fails to indicate how much revenue this might produce. On the basis of the Carter Commission's research, we estimate that more than $60 million could be generated from this source, assuming the proposal is feasible to implement.[5] These three important revenue-producing reforms alone, which are excluded

[3] Hon. Charles MacNaughton, "Revenue Impact of the Federal White Paper on Tax Reform Proposals", Statement to the Ministers of Finance meeting, Quebec City, February 2-3, 1970.

[4] *Analysis of the Federal Tax Reform Proposals, op.cit.*

[5] The problems of taxing non-resident capital gains are discussed in Chapter 9.

from the federal estimate, bring the revenue gain up to almost $1 billion. The special study accompanying this paper fully documents our revenue estimates.[6]

Longer-Run Revenue Implications

We are conducting a study on the implications of the white paper for long-run revenues and public sector growth. We expect to publish the results of this study within the next few weeks. Our interim findings for 1975 and 1980 indicate that the federal tax proposals would generate huge revenue increases for the federal government. This would lead to revenue-induced spending and a steadily increasing share of national income being commanded by government. We suspect, however, that these projected gains will never be realized. Such a high-tax regime could well result in reduced growth and performance in the Canadian economy and less real benefits for all.[7]

It has been suggested that, if too much revenue is produced by the federal proposals, tax rates could always be reduced. Our observation would be that governments are chronically reluctant to recognize that they have taken too much from taxpayers. A far better approach would be to incorporate lower tax rates as an integral part of the reform legislation itself. We strongly urge, therefore, that the national reform package be designed to produce no net revenue gains to government.

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[6] *Analysis of the Federal Tax Reform Proposals, op.cit.*

[7] The danger of adverse behavioural reactions to the new tax system was one of the reasons why the Ontario Government called for a thorough study of the economic implications of the federal tax proposals in its submission to the Ministers of Finance meeting, February 2-3, 1970.

3 INDIVIDUAL INCOME TAX REFORMS

The Ontario Government supports the objective of improving the equity of the individual income tax. We recognize that the present income tax system contains major equity defects. Persons in similar circumstances often do not pay the same amount of income tax. The tax burden placed on low-income families and individuals is too heavy. This is especially true where inflation has eroded the purchasing power of fixed incomes and the value of tax exemptions. Some high-income taxpayers can escape paying their fair share because of loopholes and the absence of a capital gains tax. We are convinced that changes are required to correct these defects and to strengthen the ability-to-pay foundation of Canada's income tax structure. At the same time, it is important that any new measures introduced not create major new inequities.

Key Requirements

In our view there are six key requirements for real reform of the individual income tax.

1. The heavy tax burden should be reduced for low-income taxpayers.

2. The tax base should be broadened to include presently sheltered forms of income.

3. Employment income should be treated more fairly.

4. There should be adequate allowances for working mothers and single parents.

5. Tax loopholes and abuses should be eliminated.

6. The rate schedule should be revised and simplified.

The federal white paper advanced proposals for reform in each of these key areas. We have submitted our views on the federal proposals and offered constructive suggestions at a number of federal-provincial conferences. The following paragraphs elaborate on our views and put forward, for discussion, our proposals for comprehensive reform.

1. Tax Relief for Low-Income Families and Individuals

The Ontario Government commends the objective of reducing the income tax burden on low-income taxpayers and removing from the tax rolls those individuals and families who should not be paying income taxes at all. However, we do not believe that an across-the-board increase in personal exemptions is the best and fairest means of achieving this objective. Increased personal exemptions are costly in terms of revenue loss, which must be recouped by significantly higher rates as the white paper demonstrates. For this reason, exemption levels tend to become frozen once established, and quickly lose their tax relief value in succeeding years. Moreover, increased exemptions are of no value at all to the

millions of Canadians whose incomes fall below the existing level of exemptions. For these Canadians in greatest need the real burden of taxes arises from property taxes, health insurance premiums and sales taxes. The Ontario Government strongly urges that relief of the provincial-municipal tax burden on the lowest-income Canadians be accorded the highest priority in comprehensive tax reform.

We believe that tax relief can best be provided to those groups who need it most through various selective measures. We suggest a combination of two new measures in place of the proposed increase in personal exemptions:

- a low-income allowance (additional exemption for low-income taxpayers) to remove the income tax burden on people in the lowest brackets and to provide gradually tapering relief to people in the lower-middle brackets; and
- refundable tax credits to offset the provincial-municipal tax burden on those people who do not earn enough to pay income taxes.

A low-income allowance along the lines recently enacted in the United States could be designed to produce the same results as envisaged in the white paper. Income taxes for single persons with total incomes below $1,500, couples below $2,900 and families of four below $3,500 could be eliminated. To avoid sharp cut-off points above these levels, the benefits of such allowances could be gradually phased out over the next $1,500 of income. Such a selective measure would confine income tax relief to taxpayers below $5,000 of total income; hence, it would cost perhaps $250 to $300 million, which would be far less than the $1 billion revenue cost of across-the-board increases in exemptions. The resulting savings would then permit reductions in the white paper rate schedule, tax credits to the very poor and more suitable provisions in other areas.

The Ontario Government has stressed consistently that meaningful and comprehensive tax reform in Canada must take into account the heavy burden of property tax and other regressive taxes being borne by our poorest citizens and those who have not shared fully in the economic advance of recent years. We believe that revenues from income taxation should be used to offset provincial-municipal taxes, which are not related to individuals' ability-to-pay, in order to achieve adequate redistribution of total tax burdens. As emphasized in our own white paper, such comprehensive reform can best be accomplished through the income tax system. Consequently, we recommend that the revised income tax incorporate credits against income tax liability for property taxes and other taxes paid to provincial-municipal governments. Because such integration of tax burdens will be costly in terms of revenue, we suggest that, initially, tax credits be available only to those people who do not earn enough to pay any income tax.

For these Canadians, an income tax credit would amount to a refund of all or part of their property taxes, sales taxes and health premiums. Presently there are 1.5 million people

who file tax returns but pay no income tax; a further substantial number, perhaps 1 million, could be expected to file returns to qualify for refunds. This would mean, for example, that refundable income tax credits averaging $100 would cost about $250 million. This compares with the $1 billion tax loss from across-the-board higher exemptions. This integrated tax credit approach has the merit of taking total tax burdens into account, not just income tax burdens. Unlike the federal proposal to increase exemptions, it would provide real relief to those taxpayers who most need equity.

2. Broadening the Tax Base

The Ontario Government agrees with the federal proposals to broaden the tax base to include presently sheltered forms of income. The present tax-free status of capital gains, in particular, is an obvious source of inequity and distortion. In Chapter 5 of this paper we set out our views and proposals for the taxation of capital gains.

We concur with the federal proposal to include, as taxable items, other forms of income now exempt – unemployment insurance benefits, scholarships, adult training allowances, and medicare premiums paid by employers. At present, a person receiving unemployment insurance benefits for part of the year and regular income for the rest pays less tax than a person employed for the entire year and earning the same total income. Increased unemployment insurance benefits would compound this unequal treatment of equals. In respect of employer medicare contributions, we point out that the white paper failed to mention the large revenue increase entailed in including this fringe benefit in taxable income. We estimate that, in Ontario alone, this change would generate $57 million of increased revenue, thus substantially offsetting the benefits of the proposed employment expense allowance for most employees.

We suggest that strike pay should also be included in taxable income. Since supplementary unemployment benefits are taxable and unemployment insurance benefits are to be taxable, consistency and equity require that strike pay also be taxable, especially since union dues are deductible.

3. Fairer Treatment of Employment Income

One of the major deficiencies of the present tax law is the unfair treatment of employment income. Ordinary wage and salary earners are allowed to deduct almost no expenses incurred in earning income, while very liberal expense deductions are available to self-employed persons. The white paper proposes to remedy this defect by establishing a 3 per cent employment expense allowance in recognition of expenses legitimately incurred in earning wages and salaries. We agree with this approach, but we do not believe that the federal proposal is adequate. We suggest that the $150 ceiling of the 3 per cent employment expense deduction be increased to $300. This is an arbitrary figure, but we believe that it

represents a more appropriate allowance for the costs of earning income. In addition, it would be appropriate to provide an option for the deduction of certain employment expenses on an itemized basis. This more generous employment expense allowance or itemization option which we are proposing would ensure approximately equal treatment of employment and self-employment or business income.

We also suggest the elimination of the present special deduction for union and professional dues and other special employment deductions. These costs of earning income could then be incorporated into the more liberal employment expense deduction plus itemization option which we are proposing. This rationalization, plus the additional revenues from taxation of employer medicare contributions, would substantially offset the revenue loss from more generous provisions for employment expenses. The result would also be fairer.

4. Allowances for Working Mothers and Single Parents

The Ontario Government endorses the principle of providing a special tax allowance to working mothers. When both parents work, there are additional child care expenses and other family costs which should be recognized in the tax system. We also believe that such a special allowance should primarily benefit low-income families, where the second parent often works out of necessity rather than choice. To achieve this result, a tax credit approach is clearly superior to the exemption approach.

We do not believe that the white paper proposal in this area will be of real value to the great majority of working mothers or single parents. The itemization and receipts requirement alone will rule out any benefits to the great majority of families who have informal or swapped babysitting arrangements, or whose children are in school. Thus, under the white paper proposal, most working mothers and single parents would have to pay out \$4 for child care costs in order to obtain \$1 in tax reduction. Disallowance of claims for child care by dependent relatives will also limit the value of this reform for many low-income families. Eligibility of boarding school and summer camp costs, on the other hand, will unduly bonus middle and high-income taxpayers for these elements of personal consumption.

We recommend that tax credits be allowed to working mothers and to single parents who work. We suggest a flat \$50 tax credit to all working mothers or single parents who receive the family allowance, plus an additional \$100 tax credit if there are any pre-school children in the family. Thus any working mother whose children are in school would receive a \$50 tax credit and any working mother with at least one pre-school child would qualify for the maximum credit of \$150. These credits would be of equal value to all taxpayers regardless of their income level and would be available without verification. We recognize that our alternative would provide lower benefits than the white paper proposal to some

working mothers who are now paying substantial amounts for child care. On the other hand, our alternative would provide genuine relief to all working mothers and single parents, including the great majority who cannot afford expensive child care arrangements. We estimate that a tax credit measure along these lines would involve a revenue loss of approximately $50 million annually.

5. Eliminating Loopholes and Abuses

The Carter Commission was extremely critical of loopholes and abuses in the Income Tax Act which allow some taxpayers to avoid paying their fair share of tax. The white paper proposals recognize the need to eliminate loopholes and abuses in the following manner: by closing avenues for obtaining tax-free income, by imposing more rigorous limits on expense account living and business expense deductions, and by taxing non-cash benefits such as the personal use of a company car. The Ontario Government fully concurs with this reform thrust, as long as legitimate expenses are recognized and enforceable rules are established. We are convinced that a tax system based on self-assessment will not work effectively unless the bulk of taxpayers accept the law as reasonable and believe the same rules apply to everyone.

At the same time, we believe that loopholes can and must be dealt with on a selective basis. In a number of instances the white paper proposal seems either too global or is likely to prove unworkable. We do not believe that provisions deliberately designed to stimulate economic growth are loopholes, although it may be appropriate to review and change such provisions for other reasons.

6. Revised Rate Schedule

The marginal rate schedule is obviously a vital part of a reformed income tax. It determines the revenue yield and the elasticity of the tax. It defines the appropriate progressivity between taxpayers at different levels on the income scale. It is the yardstick against which taxpayers gauge their future expectations and plans. For these reasons, a new rate schedule should be as well-conceived as possible and must have some degree of permanence for a number of years in the future.

The Ontario Government has three basic objections to the new rate schedule proposed in the white paper:

- the federal rate schedule has been set unnecessarily high and will produce large revenue gains, particularly from middle-income taxpayers;
- the temporary 3 per cent surtax has been perpetuated in the new rate schedule; and

- reduction of the top marginal rate to 50 per cent provides unwarranted tax reductions to many high-income taxpayers. This proposal seems to be one of the significant sacrifices necessary to make integration work.

As already stated, we stand by the principle that tax increases should be legislated on their own merits rather than under the guise of reform. We believe that the Carter Commission adopted the right approach in offsetting revenue gains in the corporate area through tax reductions in the individual income tax. Recent tax reform in the United States followed a similar approach. The white paper, however, builds in overall tax increases, including increases in the personal income tax. We believe that this is a fundamental flaw which undermines the positive aspects of the reform proposals. We strongly recommend that the rate structure be modified to generate income tax reductions equal to revenue gains from reforms in the corporate area. In this way, middle-income taxpayers need not pay more, yet there can be significant tax relief at the bottom end of the scale.

The new rate structure proposed in the white paper perpetuates the 3 per cent surtax which was imposed as a temporary anti-inflation measure in 1968. We believe that this kind of manipulation undermines taxpayer morale and confidence in short-run stabilization measures. In the tax reform legislation in the United States, the temporary surtax was explicitly terminated rather than carried on in a hidden form. We recommend a similar course of action for Canada.

The Ontario Government rejects the proposal to reduce the top marginal rate to 50 per cent as a retrograde step. This proposal would provide huge tax reductions ($40 million worth) to a few thousand individuals with very large incomes. A self-employed person earning $200,000, for example, would get a tax reduction of $25,000 or 20 per cent. We suggest, therefore, that a top marginal rate of at least 65 per cent be retained. This top rate could be applied against taxable income in excess of $100,000 to produce roughly the same tax effects as the present higher income tax rates. Scrapping of the "ostentatious" rates up to 82 per cent could then be undertaken at insignificant revenue cost and without unduly bonusing very high-income taxpayers.

New Dimensions

In addition to these six key requirements, reform of the income tax could well embrace other desirable features. We are interested in new initiatives in three areas:

- reduced taxes on overtime and second-job income;
- a more humane and flexible approach to financial transfers in cases of divorce and separations; and
- a savings incentive for ordinary taxpayers.

The present system penalizes overtime and second-job earnings. The additional income from overtime work or a second job often moves a taxpayer into a higher marginal bracket. For instance, a man earning \$7,000 per year by working 60 hours a week pays the same tax as another man earning \$7,000 but working 40 hours a week. The present tax system treats these two men as equals despite the fact that one man has foregone all his leisure time in order to increase his earnings. We believe that the income tax system could well provide some recognition of the extra effort involved and make the choice between leisure and extra work more neutral than at present.

In our view, the present tax system is unnecessarily rigid in its treatment of taxpayers who are divorced or separated. Generally, alimony and support payments are treated as income to the recipient and allowable deductions to the paying party. In practice, however, the present tax law often distorts the pattern of financial arrangements which may be desired by the persons involved in separation or the dissolution of a marriage. Transfers of a capital sum, for example, may be better suited to the new circumstances of the former partners than continuing alimony or support payments. Similarly, transfers may be voluntary rather than enforced by legal agreement or court order, yet such transfers are not now deductible. The tax law should be sufficiently flexible to accommodate such personal interests of taxpayers. Tax provisions certainly should not create unnecessary hardships for people in these circumstances by distorting their financial arrangements. We recommend, therefore, that those provisions of the Income Tax Act which touch upon divorce or separation should be amended to make them more flexible and bring them more in line with current social realities.

The Ontario Government also believes that the income tax system should provide a positive encouragement for savings out of income, particularly savings by taxpayers with modest incomes. At present, there is a significant tax incentive for retirement and pension savings. We would be in favour of an additional incentive, in the form of a tax credit, for non-retirement savings plans of various kinds. We suggest a tax credit of \$25 for every \$100 of annual savings up to \$300 be available to taxpayers who participate in payroll savings plans approved by the federal government. Only plans that are long-run in nature and that lock in savings for five years or more should be eligible. Such a savings incentive provision would encourage thousands of ordinary Canadians to build a stake in Canadian growth.

4 CORPORATE TAX REFORMS

The federal white paper has proposed a radical and complicated restructuring of the taxes on corporations and their shareholders. There is to be a new set of artificial distinctions among types of corporations – widely-held Canadian corporations, closely-held Canadian corporations and foreign corporations. In addition there is to be differential tax treatment of the dividend income and capital gains arising within each of these categories. Specifically, half integration with half capital gains is proposed for widely-held companies, full integration with full capital gains for closely-held companies and no integration with full capital gains for foreign companies. The Ontario Government has carefully considered this complex package of structural changes. In our view, the supposed technical advantages of this type of theoretical experimentation are far outweighed by losses in equity, simplicity and flexibility. We have come to the conclusion that the proposed new structure is substantially less suited to Canadian needs than the present system of taxing corporations and their shareholders.

Shortcomings of the Proposed Structure

Our objections to the proposed new structure for corporate and shareholder taxation rest on a number of factors. We see many defects and problems in such a technically complex system which will produce adverse effects and render it unworkable in practice. We share the views of many observers who have critically examined the proposals. We have found such shortcomings as the following points.

- The new system will be inherently unstable. It is not possible to establish significantly different sets of rules for different types of companies covering essentially the same business transactions without creating severe strains on the viability of such a system.
- There are too many exceptions to the assumption that closely-held and widely-held corporations do not compete for such a distinction to be valid. We do not think that this distinction can or should be made. However, we believe that some new approaches are possible in dealing with those smaller companies which are similar to unincorporated proprietorships and partnerships.
- Different tax rules applying to different classifications of corporations will inevitably create opportunities for tax manipulation. There will be a strong tax motivation to structure business transactions in ways which seek to thwart the intent of the rules. Where this occurs, the only alternatives will be to abandon the different rules as unworkable or to attempt to freeze business arrangements in their original form.
- One problem which the new structure seeks to solve – dividend stripping – is no longer a serious problem. Changes in legislation and recent court rulings have

minimized this abuse. Any residual problem could be handled by minor modifications in the existing tax system together with realization of capital gains at death, as the Ontario Government is proposing.

- The differential integration and capital gains provisions will undermine the efficiency of capital markets. Investment decisions will be greatly influenced by tax effects rather than by economic merit.
- The effect of the integration proposals is to discriminate against Canadian-based international companies, the Canadian-owned steel companies and other high-productivity companies with insufficient creditable tax. Dividends from companies operating abroad and from the steel and resource companies will qualify for less integration benefits than dividends from ordinary Canadian companies. This will leave their shareholders worse off than at present, and increase the cost of raising equity capital in Canada for our steel companies and multi-national companies.
- The integration provisions will tend to shift Canadian equity investment out of the growth, technology and risk-oriented companies into conservative, high-dividend companies. This would result in less Canadian participation in growth industries and in the exploitation of new technologies which will propel economic growth in the 1970s and 1980s.

The Ontario Government also rejects the federal integration proposal as unfair in principle. We are not impressed by the theory that income taxed in the hands of the corporation should not be taxed when it is passed to shareholders as dividends. The argument against so-called double taxation ignores the fact that the bulk of corporation taxes is shifted to consumers in the form of higher prices. Why should taxes borne by consumers be credited back to shareholders? If this is fair, why not also credit back to shareholders, the sales taxes paid by corporations? On this reasoning, why not simply reduce corporate taxes so that some of the 'integration benefits' can be shared by consumers?

Dividend integration is also unfair because, to be workable, it requires reduction of the top marginal rate of income tax to 50 per cent. As already pointed out, we regard this by-product of integration as a retrograde step which stunts vertical equity in the income tax system. We do not recognize as reform a policy which would give Canada's high-income people an unwarranted reduction in their income taxes.

Integration would also significantly inhibit the flexibility of fiscal policy. The scope for short-run anti-cyclical tax measures, for example, would be narrowed if corporate and personal income taxes were directly linked together. Revenue-raising tax measures would also be more difficult under an integration regime. To make a desirable tax change in one field, the combined impact over both tax fields would have to be taken into account.

The Ontario Government strongly recommends retaining separate taxation of corporations and their shareholders. We do not agree that, in the matter of taxation, corporations are or should be treated merely as vehicles or expressions of the collective interests of their shareholders. The management groups of many corporations, particularly if they are large, function as independent decision-making units which profoundly influence economic activity and the shape of our society.

Ontario Government Proposals

Our proposals in the area of corporate taxation are simple and straightforward. We reject the radical changes proposed in the white paper, that is, dividend integration and complex distinctions among types of corporations. Instead, we recommend retaining the present well-tested system of taxing corporations and their shareholders. This approach has major advantages, not the least of which is to avoid the serious problems which would arise under the white paper system. The tax treatment of utilities, the discrimination against Canadian-based international companies, the tax treaty implications, and the tax manipulation danger, to name but a few, would present no problems. Moreover, the present structure leaves ample scope for introducing a reasonable capital gains tax, one which can stand on its own rather than requiring elaborate compensating offsets in other tax areas.

The Ontario Government also favours retention of the dividend tax credit. This incentive to Canadian taxpayers to acquire shares in Canadian companies has worked effectively in the past. It has led to broader participation by Canadians in equity investments, and it has resulted in gradual repatriation to Canada of shares in a number of major corporations. We do, however, recommend a minor modification of the present dividend tax credit to improve its equity and its effectiveness as an incentive to Canadian ownership. We suggest a 30 per cent credit on dividend income up to $100, a 25 per cent credit on dividends between $100 and $500, and a 20 per cent credit on dividends over $500. Such a change would provide proportionately higher benefits to low and middle-income groups who generally have only modest dividend income. At the same time, it would slightly increase the incentive for well-to-do Canadians to invest in Canadian companies.

5 TAXATION OF CAPITAL GAINS

The Ontario Government has recommended the introduction of a reasonable capital gains tax in Canada. In our 1969 white paper on tax reform, we argued that capital gains must be taxed in order to achieve greater equity in the tax system. Subsequently, the federal government also proposed to tax capital gains. We agree with this reform objective, but strongly object to the form of capital gains tax outlined in the federal white paper.

Deficiencies of the Federal White Paper

It is the view of the Ontario Government that an appropriate capital gains tax for Canada must meet four simple criteria.

1. It should be demonstrably fairer than the present system of tax-free capital gains.
2. It should minimize adverse economic effects.
3. It should be administratively workable.
4. It should not interfere seriously in the regular business transactions and day-to-day lives of Canadians.

The white paper proposals for capital gains taxation do not stand up to any of these tests.

1. Equity

The white paper proposes to apply different rates of tax on different kinds of capital gains – half rates on widely-held Canadian shares and full rates on most other kinds of gains. We believe that this amounts to a gross violation of the principle of the equal treatment of equals. What is fair about taxing one individual $50 on a share gain and taxing another individual in similar circumstances $25 on an equal share gain? What is fair about taxing one individual on his share gains every five years and letting another individual pass his share gains free from tax from one generation to the next. The initial valuation procedure proposed in the white paper is also unfair. It could amount to retroactive taxation on gains which merely restore the original value of an investment portfolio.

2. Economic Effects

The white paper proposals will generate major economic distortions and seriously penalize private savings, innovation and enterprise. The proposed system will deter companies from going public, will discourage foreign corporations from offering equities to Canadians and will lock in investors. The five-year deemed realization provision could force a sell-out of majority interests and the loss of Canadian ownership and control. The high capital gains rate – up to 50 per cent – and the lack of any offsetting provisions on death

taxes amounts to punitive taxation. This is also an excessive level of taxation compared to that in the United States. It will reduce personal savings and investment and jeopardize Canada's economic growth prospects for the seventies. Moreover, the capital gains tax proposed in the white paper risks the stability of the personal income tax base. Had this kind of tax been in force during the current stock market slump, capital losses and loss-selling would have resulted in a huge decline in government revenues, serious disruptions in capital markets, and further pressure on already weakened bond markets with their high interest rates. Such a result would also reduce the ability of provincial and municipal governments to borrow funds for essential capital projects.

3. Administration

The complex package of federal proposals, particularly differential rates, deemed realization, taxation of homes and taxation of non-residents, will be extremely difficult and costly to administer. There will be enormous computational complexities for taxpayers and strong inducements for tax manipulation. We would expect that thousands of officials would be required to administer and police such a system. Otherwise, it would be only honest volunteers who would pay, which is hardly a sound basis for taxation.

4. Interference with Taxpayers

The white paper package of capital gains provisions will interfere seriously with normal business transactions. Investment decisions and family transfers will be dictated unduly by tax consequences rather than economic merits and family requirements. Taxation of minor items and household effects will inject government back into the bedrooms as well as into the living rooms and attics of many Canadians, yet produce insignificant revenues. We believe that such increased interference would detract substantially from genuine reform.

Ontario Government Proposals

Our basic views on capital gains taxation were outlined in our white paper on provincial-municipal tax reform in 1969. The keynote of these proposals was to attain improved equity combined with administrative simplicity and minimal economic distortion. The following points re-affirm and expand upon these original proposals. We believe that a separate capital gains tax, structured along these lines, would be a positive reform and would permit a dynamic and prosperous Canada in the decades ahead.

1. Capital gains should be taxed separately and not incorporated with regular income. Capital losses should be deductible from capital gains but not from income generally.

2. All capital gains should be taxed at the same rate and on the same basis. Except as outlined here for homes and farms, we favour bringing 100 per cent of capital gains into the new tax base and allowing 100 per cent loss offset against future gains. We propose a 25 per

cent flat rate tax, a rate only slightly above the bottom marginal rate of income tax. We also would favour exempting the first $100 of capital gains in order to provide a lower effective rate to small investors. Such a moderate rate would ensure that Canada's taxation of capital gains will be no higher than effective capital gains rates in the United States.

3. Gains should be taxed only when realized or upon death or emigration. Taxing of imputed gains as proposed in the white paper is questionable in principle and enormously complicated and distortionary in practice. There should be generous provisions to handle liquidity problems, particularly for closely-held family enterprises. There should also be adequate provisions for forced realization as in the case of expropriation, and for necessary and desirable changes in the ownership of capital assets due to corporate reorganizations, mergers and the like. Provision of advance rulings and interpretations should also be considered by the Department of National Revenue, particularly for complex areas such as corporate reorganizations and acquisitions. A positive arrangement of this kind would reduce the uncertainty necessarily associated with the application of a major new tax.

4. Homes and farms should be generally exempt from capital gains taxation. The white paper appears to accept this principle but its provisions would work out far differently in practice. We propose a lifetime exemption of $50,000 for gains on homes and $100,000 on farms. These limits should, of course, be reviewed periodically. We believe a generous exemption on farms is necessary because farmers generally provide for retirement income through the capital appreciation of their property. Given these exemptions for gains on real property, there should be no allowance for capital losses on real property. In addition, we believe that a broad range of minor items such as personal and household effects and depreciable items such as cars should be exempt. Gains on higher value items such as jewellery and paintings should only be taxed at death.

5. Death and gift taxes should be drastically reduced as capital gains taxation comes into effect. Our principle is simple: if capital accumulation is taxed on a pay-as-you-go basis it should not be taxed heavily again at death. This reduction in other taxes on capital is essential to ameliorate the negative economic effects of capital gains taxation. Without this compensating adjustment, the introduction of a capital gains tax would sharply curtail the private savings and investment capital needed by Canada in the seventies.

6. There should be a distinction between short-run speculative gains and long-run investment gains. We suggest a holding period of six months to qualify as capital gains. All gains realized in less than six months would be taxed as ordinary income. The present capital-income distinctions would apply for gains beyond this holding period. This would put the Canadian law on roughly the same footing as United States capital gains tax provisions.

7. Generous rules should apply during the inception of a new capital gains tax. We believe that it is essential to ensure a fair and orderly transition from the current tax-free status of gains (upon which people have planned their affairs) to the new tax provisions. The

federal government partially recognized this equity requirement in implementing its new estate tax. We propose that, at the start-up of capital gains taxation, rules be established to permit taxpayers to use as initial value, either current value or original cost of the asset, whichever is higher, for the calculation of subsequent gains. This would ensure that investors holding equities or bonds which are below original cost will not be taxed on the rise in values back to original cost.

8. Capital gains should be taxed on a uniform basis all across Canada. A major drawback to the federal proposals is the real possibility that some provinces may refund their share of capital gains taxes in order to ameliorate the severe impact on private investment. If this kind of tax competition arises, it will not only undermine the equity goal of capital gains taxation but could also generate undesirable economic and financial distortions in Canada. We believe that the moderate and sensible capital gains tax approach that we are proposing will avoid this potential problem, and will lead to a more uniform structure of death taxation in Canada as well.

We consider that this framework would provide an acceptable and workable system for the taxation of capital gains. It has the prime merit of relative simplicity, despite the need for some complex provisions to facilitate the orderly progress of business. It recognizes the need for relating the capital gains tax to death and gift taxes. Of course, any capital gains tax – especially a new one – creates problems of economic efficiency and enforceability. Accordingly, we are prepared to consider variations within the broad framework which would assist in the solution of these problems. The only requirement is that the result must be a straightforward effective gains tax, separated from the income tax system, which will produce an appropriate amount of revenue on a fair basis.

6 TAXATION OF SMALL BUSINESSES

The Ontario Government recognizes the importance to the economy of newly established and expanding small businesses. We believe that tax incentives to small businesses merit continuation on the following grounds.

- To provide an outlet for the entrepreneurial talent and initiative of Canadians. Many large and successful Canadian companies started out as struggling small enterprises twenty years ago.
- To encourage invention and innovation. The importance of the contribution of small businesses to technological change and increased productivity has been emphasized by research in the United States. These findings indicate that small companies have made a disproportionately large contribution to economic growth.[8]
- To offset the biases against small enterprises inherent in the allocation of funds through existing capital markets.
- To offset relatively high risks, particularly in the formative years.
- To preserve small enterprises which play an important role in the social and economic fabric of Canada. We believe that there is value in maintaining a balanced economic structure in which both large and small enterprises can flourish. Small businesses can be an effective countervailing force in a world increasingly dominated by unfettered bigness.
- To promote regional economic balance within Canada. Developing areas and slower growth regions tend to be more dependent on small business enterprise.
- To provide a broad spectrum of job opportunities to Canadians. Because of their flexibility and size, small companies can often profitably employ people who might be rejected by large companies on health, age or other grounds.

Treatment of Small Businesses Under the White Paper

The white paper proposals single out small incorporated business for particularly harsh treatment. The elimination of the lower corporate rate will inhibit growth and expansion of small businesses, penalize scarce entrepreneurial talent and deter new, innovative, high-risk enterprises. Moreover, no offsetting concessions are proposed in the white paper, although the Carter Commission documented the need for generous tax incentives for small

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[8] *Technological Innovation: Its Environment and Management,* U.S. Dept. of Commerce, Washington, D.C., 1966.

businesses. The technical or revenue reasons for eliminating the dual rate may be valid. It is not good enough, however, to ignore the serious effects on small business and fail to provide a compensating alternative.

The white paper argues that it is necessary to eliminate the present concessionary rate of 21 per cent on the first $35,000 of income for three reasons. First, the establishment of multiple corporations has led to substantial tax evasion. Second, the authors of the white paper have concluded that small incorporated businesses should receive the same tax treatment as partnerships and proprietorships since they compete mainly with each other in the market place. Third, the lower rate is costly in terms of revenue and its benefits are not restricted to smaller companies.

The assumption that small incorporated businesses compete mainly with partnerships and proprietorships is very much open to question. We find it difficult to support the general proposition that incorporated small business should necessarily receive the same tax treatment as partnerships and proprietorships. In limited cases, the treatment should perhaps be substantially the same but this can be achieved in a manner which does not damage the small incorporated business in order to put it on the same footing with a similar unincorporated business. Finally, the compliance problems associated with the creation of multiple corporations have been effectively dealt with in Canada under existing law.

The proposed elimination of the dual rate also seems largely necessary to satisfy the requirements of dividend integration. Obviously, the enforcement problems under integration would be much more difficult if there were a dual rather than a single corporate rate. Since we do not accept the feasibility of the integration proposal we cannot support elimination of the dual corporate tax rate unless some effective equivalent is found. It is interesting to note that a dual rate of corporate taxation has been retained in the United States through successive tax reform programs. Moreover, in the United States a great deal of time and talent has been devoted to the question of small business taxation while similar research has been singularly lacking in Canada.[9]

Ontario Government Proposals

The federal Minister of Finance has established a committee to examine and report on the taxing of small business corporations. We commend the Minister for recognizing that a more detailed appraisal of this matter is necessary before proceeding with such a fundamental change in corporate taxation.

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[9] U.S. House of Representatives Select Committee on Small Business: *Hearings and Staff Studies,* 1941-1963, 77th to 88th Congresses (Washington, D.C., Nov. 1963).

The Ontario Government has made it explicit that it is not satisfied with taxing of small businesses as it is now being proposed in the white paper. We anticipate that the Finance Minister's Committee will advance recommendations in this regard. We would be willing to support effective measures which are designed to help the genuinely small corporations without bonusing the large ones. In our view, this assistance should take the form of limited tax credits or deferments related to increased investment in real business assets. We also envisage that the new small business incentive should be restricted to Canadians.

Farmers run small businesses of a special type. They, too, should benefit from small business incentives. They should continue to be taxed on a cash receipts basis and merit a generous capital gains exemption as suggested in Chapter 5.

The Ontario Government recommends the gradual introduction of any changes in the taxation of small business. The importance of maintaining an environment which is conducive to entrepreneurial initiative convinces us that it is imperative that alternative methods of using the tax system to encourage economic growth must be fully examined before existing incentives are eliminated.

We believe that a strong incentive to Canadians to develop and expand new and small business is both mandatory and feasible. Such an incentive should promote efficient, growing businesses. There are major defects in the present dual rate of corporate tax. However, until a new strong incentive is in place, there is no alternative to retaining the present low rate on the first $35,000 of small business income. When a new incentive is devised, it should also meet the special needs of farmers. .

7 TAXATION OF RESOURCE INDUSTRIES

The Ontario Government has consistently stressed that changes in the tax system should be considered in relation to economic growth and productivity. This is particularly important with regard to the resource industries which remain a cornerstone in the Canadian economy.

We believe that the white paper proposals are unnecessarily severe. According to our own estimates, the white paper proposals affecting the resource industries will produce an extra \$180-\$200 million in revenue, annually, once the new system is fully mature. The burden of this increased taxation, moreover, will fall very unevenly among different mineral industries. This reduction in internal cash flow, combined with difficulties in raising external funds due to reduced earnings prospects, will seriously retard the expansion of the resource industries, and curtail further exploration and development in Canada.

The proposed changes in the white paper mining incentives do not appear to be supported by any economic studies. The main defect of the federal proposals is their apparent failure to evaluate the effectiveness of the mining incentives in terms of providing desired results at minimum costs. The mining industry is a special case because of its unusual riskiness, its unique capital intensity and its dependence on international markets. These special circumstances should be considered in designing effective tax incentives for the mining industry.

The international nature of the mining industry does not appear to have been adequately recognized in the white paper. There is a limited domestic market for Canada's mineral products. There are many other countries to which international capital can be profitably moved for use in exploring and developing natural resources. It is essential, therefore, that tax provisions affecting Canadian mining should be competitive with the tax laws in other leading countries. In the particular case of the United States, it should be noted that recent tax reforms made only minor reductions in the tax concessions to the mineral industries. There was no reduction in the depletion available to iron ore or copper, two of Canada's most important minerals.

Contributions to the Canadian Economy

The Canadian mining industry makes a significant contribution to the national economy in terms of growth and productivity, foreign exchange, support of secondary industry, and regional development. The resource industries also generate substantial economies of scale in such national transportation facilities as railways, the Seaway and the new superports. As a case in point, the metal and mineral industry accounts for 40 per cent of all revenue freight traffic moved by Canadian railways, and provides over 50 per cent of the freight on inland waterways.

Through its massive contribution to exports, the Canadian mining industry plays a vital role in maintaining Canada's balance of trade. This substantial contribution to the Canadian economy should be encouraged and promoted through tax incentives. According to a recent announcement by the United States Government, new tax incentives will be proposed to encourage exporters. These measures represent a completely different direction in tax policy from that proposed in Canada.

Probably the most significant contribution of mining is its role in promoting better regional balance. Viable communities have been created in the North and other remote regions of Canada, where mining is the only base of economic development. In opening up these areas, the mining companies undertake expenditures on roads, hospitals, schools and other municipal services which governments normally finance in other parts of the country. These special social investments should be recognized in designing new tax measures for the resource industries.

Provincial Mining Taxes

Jurisdiction over natural resources in Canada was given exclusively to the provinces under the British North America Act. In Ontario, a mining tax was imposed on the profits attributable to the removal of natural resources ten years before any income tax was imposed by the federal government. This fact has been completely ignored by the white paper.

We urge the federal government, therefore, to recognize the right of the provinces to tax profits derived from the exploitation of their natural resources, and to leave them taxing room for this purpose.

Incentives for Processing in Canada

The Ontario Government was the first in Canada to grant tax allowances to mining companies building concentrators, smelters, or refineries not only within our provincial boundaries, but also in any part of Canada. We feel that the federal government should develop a long-term mineral policy that will encourage domestic processing of Canada's natural resources. The white paper not only overlooks this vital policy but also works at cross purposes with provincial plans to increase ore processing in Canada. Under the federal proposals, expenditures on new metal refineries would not qualify for the proposed depletion allowance.

Ontario Government Proposals

We agree that the present tax incentives to the resource industries are generous, but they have been effective. In such a critical area, it is important to retain effective incentives. We

believe that the federal proposals are too severe and could produce adverse economic effects which Canada can ill afford at this time.

We suggest the consideration of the following alternative for taxation of the resource industries:

- an overriding limitation on the three-year exemption for new mines, which will restrict the amount of benefits in the case of highly profitable mines, without reducing the incentive to explore and develop low-grade mines and mines in remote areas;
- an unconditional 15 per cent depletion allowance to the operators of mineral resources;
- an additional 10 per cent depletion allowance to companies which process minerals in Canada or undertake further exploration and development;
- full deductibility of provincial mining taxes;
- broader definitions of allowable expenses to include social facilities such as roads and schools; and
- a possible additional incentive to stimulate activity in remote areas or to reflect the special needs of a particular industry.

Another alternative would be to retain the basic level and form of the present incentives, but to limit the amount of the incentives which could be claimed by highly profitable mines. Where appropriate, a processing-in-Canada qualification could be attached to all or part of the incentives.

We believe that a highly efficient mining industry continues to be a cornerstone of the Canadian economy. The present mining incentives have encouraged a dynamic mining performance for Canada which must not be jeopardized. There is definitely some scope for raising additional revenues from highly profitable mines, but this should be done in a manner which still leaves Canadian mining competitive internationally. Moreover, it is important to take advantage of the incentives granted to mining to achieve a substantial increase in mineral processing in Canada. Fundamental to these views is the constitutional primacy of the provinces in mining because of their ownership of the natural resources.

8 TAX REFORM AND HOUSING

The high cost of rent or home-ownership is one of the most urgent social and economic problems facing Canada. Continuing urbanization and a high level of family formation will mean that housing will remain a critical problem in Canada throughout the 1970s. The tax system could be a positive instrument for dealing with this high-priority national problem. Tax measures can be designed both to increase the supply of housing and to provide relief for the rapidly rising costs of accommodation.

Canada's present income tax system contains no positive provisions which help people acquire and meet the costs of housing. Nor does the white paper make any proposals in this direction. The United States tax law, by comparison, allows generous deductions to homeowners for such expenses as property taxes and interest on mortgages. In lieu of these itemized deductions, apartment renters in the United States are granted a large standard deduction – which under their new reform legislation will rise to 15 per cent of income up to a limit of $2,000 by 1973. We recognize that similar provisions in Canada would be extremely costly in terms of revenue and, hence, are not fully feasible at this time. We are strongly convinced, however, that a reformed Income Tax Act should provide some recognition of housing costs.

The refundable income tax credits suggested earlier in this paper would offset the property tax component of housing costs for our less affluent citizens. Relief should also be available to those in the low and lower-middle income brackets. We suggest, therefore, that a special study be undertaken to investigate and recommend ways in which the Income Tax Act could be modified to recognize the burden of housing costs on ordinary taxpayers.

The white paper makes several proposals which would adversely affect housing. The elimination of the dual corporate rate, for instance, would hit hard at the house-building industry which largely consists of small incorporated businessess. This reinforces our concern that the present dual corporate rate be retained, at least until some effective alternative incentive is designed. The white paper also proposes to disallow the deduction from other income of rental losses arising from depreciation, property taxes or interest. We agree that the current loss offset provisions do represent a device which can be used by wealthy taxpayers to reduce or eliminate their tax on other income. At the same time, we recognize that the current provision is a useful economic incentive. The white paper proposals to cancel this loss offset provision are too global in approach. They give away far more in economic costs and equity losses than they produce in equity gains. The proposed reforms, in fact, would not only reduce the flow of private investment funds into housing but also would push up rent payments for millions of Canadians.

The Ontario Government strongly objects to the proposed changes in this area, at least in the form outlined in the white paper. As a minimum, we suggest that the current rental

loss offset be retained, but restricted to residential properties. This would have two advantages over the white paper blanket proposal. First, it would not worsen the rent and mortgage financing situation. Second, it would not make apartment projects relatively less attractive than they are now.

Good housing for Canadians is a top social priority. Housing at a price people can afford depends on several things – efficient builders, municipalities which can finance essential services, an adequate level of savings for investment in new housing, and recognition of the regressive burden of the municipal property tax. Positive tax reform must recognize these requirements: by strong growth incentives to small business, assurance of adequate revenues for municipalities, avoidance of damaging reductions in the level of Canadian savings, and continuing rental loss offsets which encourage investment in apartments. Moreover, we are convinced that we must provide overdue relief for the high costs of accommodation. We are suggesting refundable income tax credits in recognition of the property taxes or rent paid by those families who do not earn enough to pay income tax.

9 INTERNATIONAL ASPECTS

Canada is very much an open economy, particularly in respect of international capital flows and trade. This limits Canadian tax autonomy especially in the field of corporate taxation. We question, therefore, whether the white paper structural changes are indeed feasible to implement. It would seem to us that the viability of the white paper package depends far too heavily upon the negotiation of a favourable tax treaty with Canada's trading partners, particularly the United States. We do not believe it is either prudent or necessary to stake the success of domestic tax reform upon the federal government's prowess at the international bargaining table.

Since the success or failure of the tax reform proposals depend in large measure upon renegotiating existing tax treaties, can the federal government demonstrate why it feels confident that it can conclude agreements compatible with its plans? Even assuming that treaty negotiations are not a problem, will there not still be a problem of synchronizing these negotiations with the implementation schedule of the white paper reforms? In view of the French precedent, can it not be anticipated that the United States will seek to obtain integration benefits or some equivalent for its citizens? What would be the costs of conceding on this score – embarrassingly large we would guess. Since the white paper plans to obtain large revenue gains from the reform proposals, is it possible that this represents a cushion or contingency fund for financing non-resident integration? We believe that Canadians deserve more information on this critical international dimension of tax reform. We are not asking the federal government to tip its hand in advance of bargaining, we merely ask that Canadians be informed of what is at stake and what is being thrown onto the table.

The white paper makes a number of proposals to eliminate tax-haven opportunties by means of international operations. We agree with this reform thrust. We would hope, however, that this necessary tightening can be accomplished without introducing unduly complex rules, elaborate reporting requirements and the other trappings of an administratively oriented tax regime.

The white paper also proposes to tax capital gains of non-residents. How this is to be done, the rate to be applied, and the revenue yield expected are not spelled out in the white paper. We would expect that this departure from the conventional approach – that is, taxing capital gains of residents only – could well be difficult or impossible to enforce. Like other proposals in the white paper, this initiative may simply encourage the creation of tax vehicles and types of transactions expressly designed to escape the tax. The result of such vehicles might be to prevent share investments now owned by non-residents from ever being sold to Canadians.

One major implication of the white paper which concerns us is the potentially adverse effect on Canadian-based international companies. The denial of integration benefits to

shareholders in such companies will create a climate which is unattractive for our existing multi-national corporations or for the establishment of new ones. We believe that these corporations generate substantial advantages to the Canadian economy in terms of technology, scale, specialization and exports. Canada now has the means to become an increasingly important and profitable base for world capital, enterprise and technology. Surely, we should be trying to preserve these advantages and to continue participating in the big league of international competition.

The international dimension of tax reform is obviously a complex area and one in which leadership and responsibility fall to the federal government alone. We feel obliged, however, to express our concern whether Canada is sufficiently strong in international trade and capital markets to pioneer a tax system fundamentally different from that in the United States. We also question the wisdom of risking domestic tax reform because of external considerations. If treaty negotiations are not successful, the white paper plan for tax reform could bog down and require overhauling before it became effective operationally. We believe that our proposals for a moderate and straightforward capital gains tax and retention of the present corporate tax structure would produce minimal problems on the international side.

10 SUMMING UP

The Ontario Government's basic premise is that tax reform should meet the needs of taxpayers first and governments second. This means, for us, that tax reform should be comprehensive. It should redistribute total tax burdens and provide positive benefits to our least fortunate citizens. It means that reform should produce substantial and lasting gains. It means that tax reform should not be used as a vehicle for increasing taxes. Above all, it means that tax reform should be for people. The pressing need for reform of the taxes bearing on Canadian individuals and families cannot be allowed to take second place to experimental and highly complex changes in the taxing of corporations. Accordingly, the major thrust of our reform proposals is in individual taxation, where tax relief and the broadest possible equity and growth impacts have been our primary goals.

The package of reforms presented by the Ontario Government would result in an overall decrease of about $300 million in the income taxes paid by Canadian individuals and families. Tax reductions to people would be concentrated at the low end of the income scale. The refundable income tax credits would provide some $250 million of positive relief to the millions of Canadians who do not earn enough to pay income tax. The low-income allowance would eliminate or reduce the income taxes of taxpayers with incomes below $5,000. Higher-income Canadians would, of course, have to contribute more in order to help finance this redistribution, but not nearly as much more as proposed in the federal white paper. Indeed, our reform package would require increases in the rate schedule only half as steep as those proposed by the federal government.

To help finance urgently required reforms in the taxation of individuals and families, we believe it is also appropriate to use revenue increases from other tax fields. Thus, the net revenue loss of $300 million in the individual income tax field would be recouped through revenue increases from a capital gains tax, less generous but more effective incentives to the resource industries, and substitution of an effective small business incentive for the present dual rate system of corporate tax. In a nutshell, our proposed reforms would distribute overall tax burdens more fairly, build in powerful incentives for savings and Canadian ownership, and raise the same amount of revenues as the present tax system, as shown in the following table.

We are confident that the reform program which we have set out would provide positive benefits to Canadian taxpayers and would strengthen Canada. Our approach to equity embraces all taxes, not just income taxes, and all low-income Canadians, not just those who earn enough to pay income taxes. Our approach to economic growth and Canadian ownership incentives rests on the responses of individual Canadians. The dividend tax credit is for individual shareholders, and does not depend on what corporations do. The savings credit seeks to motivate and reward individual taxpayers. The small business incentives we advocate would also be for Canadian businessmen and farmers. We propose a reasonable

capital gains tax along with reduced death taxes, not only to minimize adverse economic effects but to maintain reasonable uniformity in the national tax structure. Our reforms are simple and straightforward, reforms which people can readily understand.

We advance our reform proposals not only for the benefit of Ontario but all of Canada. To achieve these benefits and to arrive at widely acceptable national tax reform, full co-operation and commitment by all the provinces and the federal government is necessary. We are prepared to participate fully and contribute constructively to this end. We intend to be flexible in respect of our specific reform proposals and the techniques for achieving reform, but we intend to stand firm for the essential objectives which we are seeking to achieve.

POTENTIAL REVENUE IMPLICATIONS OF ONTARIO PROPOSALS

	Revenue Losses and Gains in Canada as Compared to the Present Tax System
	$ Millions
Changes Affecting Business	
1. Substitute effective small business incentive for present dual rate of corporate tax	+ 150
2. Substitute new resource industry incentives for the present incentives	+ 50
Capital Gains Taxation	
3. Introduce reasonable capital gains tax and reduce death taxes	+ 100
Changes Affecting People	
4. Introduce refundable income tax credits to poorest Canadians	– 250
5. Introduce low-income allowances to provide tax relief to low-income taxpayers	– 250 to 300
6. Introduce generous employment expense allowance (3% up to $300 or itemization of actual expenses, plus elimination of special deductions for union dues, etc.)	– 300 to 350
7. Introduce tax credits for working mothers and single parents who work	– 50
8. Introduce payroll savings tax credit	– 50 to 100
9. Revise the dividend tax credit	– 25 to 40
10. Include medicare premiums paid by employers in employee income	+ 75
11. Include unemployment insurance benefits, adult training allowance, etc. in income and allow deduction of unemployment insurance premiums paid by employees	+ 25
12. Tighten up treatment of expense deductions, fringe benefits, etc.	+ 25
13. Miscellaneous changes: include strike pay in income, reduce top marginal rate to 65%, liberalize treatment of divorce and separation payments, etc.	–
– Potential revenue loss under present rate schedule	– 500 to 665
– Potential revenue gain if white paper rate schedule were applied	+ 1255
14. Reduce and modify white paper rate schedule to produce no overall revenue gain	– 590 to 755
OVERALL REVENUE EFFECT	0

Notes: The figures shown for corporation and capital gains taxes represent our view of what would be an appropriate revenue increase in these areas when reform is fully implemented. The figures for the personal income tax field represent our initial estimates of the losses and gains if our reform proposals had been in effect in Canada in 1969.

Ontario